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Supreme Court of The United States

OCTOBER TERM, 1968

No. 532

DARLINGTON-HARTSVILLE COCA-COLA BOTTLING COMPANY, INC., *Petitioner*

versus

UNITED STATES OF AMERICA, *Respondent*

SPARTANBURG COCA-COLA BOTTLING CO., *Petitioner*

versus

UNITED STATES OF AMERICA, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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Petitioners pray that a writ of certiorari issue to review the judgments of the United States Court of Appeals for the Fourth Circuit entered in the above cases on March 26, 1968.

OPINIONS BELOW

The opinion of the District Court for the District of South Carolina is unreported. The opinion of the Court of Appeals for the Fourth Circuit is reported at 393 F2d 494. Copies of both opinions are printed in the Appendix, *infra*, pps. 16-22.

JURISDICTION

The judgment of the Court of Appeals was entered March 26, 1968, and the petition for rehearing was denied June 21, 1968 (Appendix, *infra*, p. 19). The jurisdiction of this Court is invoked under 28 U.S.C. §1254 (1).

QUESTIONS PRESENTED

(1) Must an expenditure be capitalized *per se* where it secures for the taxpayer a business advantage or benefit extending beyond the taxable year?

(2) Were the 1964 payments by Petitioners securing business advantages or benefits extending beyond the taxable year of payment deductible as ordinary and necessary business expenses?

STATUTES AND REGULATIONS INVOLVED

The statutory provision involved is Sec. 162(a) of the Internal Revenue Code of 1954 (26 U.S.C. 162(a)), the applicable portion of which reads as follows:

> (a) In General. — There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. • • •

The income tax regulation involved is Sec. 1. 162-1(a) (26 C.F.R. Sec. 1. 162-1(a)), the applicable portion of which reads as follows:

> Sec. 1. 162-1 Business expenses — (a) *In general.* Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business • • • . • • • The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is nevertheless deductible, even though such expenses exceed the gross income derived during the taxable year from such business. • • •

STATEMENT

These suits were consolidated in both the District Court and the Court of Appeals. The facts were stipulated and, in summary, are as follows:

Petitioners (Darlington-Hartsville Coca-Cola Bottling Company, Inc., hereinafter called Darlington; and Spartanburg Coca-Cola Bottling Co., hereinafter called Spartanburg) are South Carolina corporations engaged in bottling and selling Coca-Cola in separate and exclusive territories in South Carolina. They conducted their businesses pursuant to contracts with H. D. & J. K. Crosswell, Inc., a South Carolina corporation hereinafter called Crosswell. This arrangement for bottling and selling Coca-Cola in the specified territories was approved and authorized by The Coca-Cola Company, a Delaware corporation, hereinafter called Company. All rights to bottle and sell Coca-Cola initially emanated from Company or its subsidiaries and Company produced all syrup used in manufacturing the product.

Crosswell did almost nothing in the bottling and selling of Coca-Cola. Nevertheless, because of its contract with Company, Crosswell realized certain specified gross profits on every gallon of Coca-Cola syrup purchased by Petitioners. Crosswell did this by requiring Spartanburg to pay to it 10c more per gallon for syrup than it had to pay Company and Darlington, 15c more per gallon.

With increased competition and higher costs following World War II, Petitioners and Company developed a plan to be rid of Crosswell and thereby to reduce the base price of syrup by eliminating the amounts Crosswell was receiving on all syrup purchased by Petitioners (Par. (10) of the Stipulation of Facts, Appendix, *infra*, at p. 21).

Pursuant to the agreed upon plan, Company purchased all of the issued and outstanding stock of Crosswell on January 2, 1964, and liquidated Crosswell on January 5, 1964. Three days later, on January 8, 1964, Petitioners reimbursed Company their pro-rata shares of the cost of the Crosswell stock. Simultaneous with the reimbursements, Petitioners' exclusive contracts to bottle and sell Coca-Cola in their

respective territories were surrendered and replaced by others reflecting the elimination of Crosswell and its override on syrup. The January 8, 1964 contracts did not otherwise alter Petitioners' rights to bottle and sell Coca-Cola (Par. (14) of the Stipulation of Facts, Appendix, *infra*, at p. 22).

In their 1964 income tax returns, Petitioners claimed deductions for their payments reimbursing Company. The Commissioner of Internal Revenue disallowed the deductions. Petitioners paid the resulting deficiencies and, in due time, commenced actions for recovery in the District Court, invoking that Court's jurisdiction under Title 28 United States Code, Sec. 1346(a)(1). The District Court upheld the action of the Commissioner, denying any deduction for Petitioners' payments. Petitioners appealed to the Fourth Circuit Court of Appeals, invoking that Court's jurisdiction under Title 28 United States Code, Sec. 1291. That Court affirmed the decision of the District Court.

REASONS FOR GRANTING THE WRIT

In affirming the District Court's decision, the Fourth Circuit Court of Appeals decided an important question of Federal law which has not been, but which should be, settled by this Court. For this reason the Court should grant the writ.

The decisions below have prescribed a rule that an expenditure constitutes a capital expenditure where it obtains for the taxpayer a business advantage extending beyond the taxable year. Both the District and the Fourth Circuit Court cited as authority for this its decision *U. S. v. Akin*, 248 F2d 742 (10 Cir. 1957) and *Richmond Television Corp. v. U. S.*, 345 F2d 901 (4 Cir. 1964). Neither of those cases, however, raised the question; therefore, the language in the decisions cited as authority for the rule at best is *obiter dictum*.

It is important that this Court settle the question raised in these cases. Disallowance of deductions claimed for expenditures on the basis that the advantages or benefits secured extend beyond the taxable year will create chaos and confusion, because many such deductions historically have been allowed. Great numbers of taxpayers have claimed, and

Respondent has allowed, deductions for many expenditures which secured business advantages or benefits extending beyond the taxable year of the expenditures. For example, deductions have been claimed and allowed for the following types of expenditures:

(1) Expenditures regularly made in connection with the training of insurance agents by corporations carrying on life insurance businesses, which agents serve the corporations over more than one year, hopefully for their entire working careers.

(2) Expenditures regularly made by automobile dealers to train mechanics who serve the dealers over more than one year.

(3) Expenditures made by manufacturers to consulting engineers for having reviewed plants and procedures and instituted changes resulting in benefits continuing for an indefinite period of time.

(4) Expenditures made by manufacturers to secure the rights to televise the World Series baseball games with resulting benefits continuing for several years.

(5) Expenditures made by manufacturers in certain taxable years for advertisements in national magazines resulting in benefits extending beyond such taxable years.

(6) Expenditures by motion picture producers to make "stars" of actors and actresses with resulting benefits extending over many years.

(7) Expenditures by corporations to send prospective top-management employees to advanced business administration schools for extensive training and exposure to others similarly situated, with resulting benefits extending over many years.

Application of the restriction in the decisions below will result in disallowance of deductions claimed for the expenditures mentioned, and many others of similar import.

The decisions below interpret the Internal Revenue Code to deny deduction for an expenditure where the advantage or benefit secured by the expenditure runs beyond the taxable year of the expenditure. There is no such restriction provided for in the Internal Revenue Code. We respectfully submit that an earlier decision of the Fourth Circuit Court of Appeals itself

correctly applies and interprets the applicable law and demonstrates allowance of deductions for expenditures despite the fact that advantages and benefits secured extend beyond the taxable year. See *Marsh Fork Coal Co. v. Lucas*, 42 F2d 83 (4 Cir. 1930).

The taxpayer in *Marsh Fork Coal*, made expenditures for electric locomotives, mine cars and steel rails. The normal life of all the equipment exceeded one year, that of the locomotives being estimated from 8 to 10 years, and that of the cars at about 5 years. The taxpayer contended that purchase of the equipment did not add anything to the value of the mining property, that its purchase was made necessary by the removal of coal, and that its installation was incidental to the conduct of its business. While there seems to have been no doubt about the advantages and benefits of the purchase extending beyond the taxable year, the Fourth Circuit nevertheless approved the deduction of the expenditures as an ordinary and necessary business expense. See also *New Pittsburg Coal Company v. United States of America*, 200 F2d 146 (6 Cir. 1952).

Also, other Courts of Appeal have allowed deductions for expenditures even though the advantages or benefits secured quite obviously extended beyond the taxable year of the expenditures. *E. H. Sheldon & Co. v. Commissioner*, 214 F2d 654 (6 Cir. 1954); *Cravens v. Commissioner*, 272 F2d 895 (10 Cir. 1959).

The question of deductibility of the cost of printing and distributing catalogs was involved in *E. H. Sheldon & Co., supra.* Sheldon designed, manufactured, sold, and installed laboratory equipment. In preparing and distributing catalogs, it incurred costs and claimed deductions therefor in its income tax returns. The Commissioner denied the deductions and contended that the expenditures were recoverable only through amortization over the estimated useful life of five years. Sustaining the Commissioner as to the capital nature of the expenditures, the Tax Court (19 T.C. 481) rejected Sheldon's contentions that the cost of printing and distributing the catalogs was an advertising expense, or substantially the equivalent of an advertising expense. Reversing the Tax Court and allowing the deduction, the Sixth Circuit said:

> The effect of advertising, by its nature, is usually not limited to the year in which it is done, but has a useful life somewhat indefinite in the future. *The fact that an expenditure produces something that has a useful life extending beyond the taxable year is clearly not the controlling test.* • • • It has been held a number of times that advertising expenses, even though incurred heavily in a certain year with resulting benefits over future years, is nevertheless a deductible expense for the year in which expended. (Emphasis added and citations omitted.)

It was *after* the Fourth Circuit handed down its decision in the cases at bar that the Commissioner announced his disapproval of the Sixth Circuit's decision. Rev. Rul. 68-360, 1968-28 IRB 14 (July 8, 1968).

In the *Cravens* case, *supra*, the decision dealt with the question of deductibility of expenditures for feed for cattle. The Tenth Circuit Court of Appeals ruled in favor of deduction saying:

> The fact that the expenditures covered feed for more than a twelve-month period does not convert • • • [the payment] into a capital expenditure • • •.

In a case involving a newspaper publisher, the Commissioner denied deductions on the ground that the expenditures were made to increase circulation. The Eighth Circuit, however, held the expenditures to be ordinary and necessary expenses in the nature of upkeep and maintenance of the circulation structure. *Perkins Brothers Company v. Commissioner*, 78 F2d 35 (8 Cir. 1935).

Quite obviously the advantages and benefits of the expenditures in the foregoing cases extended beyond the taxable year of the payments, yet the Courts of Appeal allowed deductions for the expenditures. Also, the Commissioner has allowed deductions for advertising expenditures since 1921 despite the fact that the advantages or benefits of the advertising may extend beyond the taxable year. O.D. 1039, 5 CB 130.

It is particularly important that the decision of the Fourth Circuit in the instant cases be reviewed in view of the decision in *Pressed Steel Car Company, Inc. v. Commissioner*, 20 T.C.

198 (1953), acq. 1956-2 CB 8. The officers of Pressed Steel signed an agreement in 1940 with another corporation requiring Pressed Steel to pay the other corporation $750 for each armored tank sold by Pressed Steel. Previously Pressed Steel had not manufactured armored tanks but thereafter it did and sold them. Pressed Steel tried to repudiate the acts of its officers and cancel the said agreement. Ultimately it paid $375,000 for the stock of the other corporation in order to liquidate it and be rid of the burdensome contract. Pressed Steel deducted the payment; the Commissioner of Internal Revenue denied the deduction. Reversing the Commissioner, the Tax Court (20 T.C. 198, 200), said:

> The evidence clearly shows that the only purpose of the petitioner in paying the $375,000 and acquiring the stock was to settle all claims against it under the agreement of July 23, 1940, and it had no intention of buying or holding that stock as an investment. The payment must be considered in accordance with the purpose for which the petitioner paid it in determining the tax consequences to the petitioner. Cf. *Kimbell Diamond Milling Co.*, 14 T. C. 74, affd. 187 F. 2d 718, certiorari denied 342 U.S. 827; cf. *Western Wine & Liquor Co.*, 18 T. C. 1090; *Charles A. Clark*, 19 T. C. 48; *Hogg v. Allen*, 105 F. Supp. 12. That purpose was to be relieved of a burdensome contract although the transaction took the form of a stock purchase. The amount is deductible as an ordinary and necessary expense of doing business or as a business loss. *Helvering v. Community Bond & Mortgage Corporation*, 74 F. 2d 727; *Camloc Fastener Co.*, 10 T. C. 1024; *Olympia Harbor Lumber Co.*, 30 B. T. A. 114, affd. 79 F. 2d 394.

Even in his belated announcement with respect to the Sixth Circuit's decision in the *Sheldon* case, the Commissioner gave no indication of withdrawing his 1956 acquiescence in the *Pressed Steel* decision.

The principle of the *Pressed Steel* decision has been applied by other courts. In *Stuart Co. v. Commissioner*, 195 F2d 176 (9 Cir. 1952), aff'g 9 TCM 585, a case quite analogous to the ones before the Court, deduction was allowed for expenditures made to secure relief from an onerous contract. In

its decision in that case, the Tax Court (9 TCM 585, 590) said:

> It is well settled that payments made to secure relief from an onerous contract are deductible as ordinary and necessary business expenses under Section 23 (a) of the Internal Revenue Code [Now Sec. 162 (a)], *Helvering v. Community Bond & Mortgage Co.*, 74 Fed. (2d) 727; affirming 27 B.T.A. 480; *Alexander J. Cassatt*, 47 B.T.A. 400; aff'd., 137 Fed. (2d) 745; *Cleveland Allerton Hotel, Inc. v. Commissioner*, 166 Fed. (2d) 805. • • •

Other courts also have applied the principle. *Metropolitan Co. v. U.S.*, 176 F. Supp. 195 (D.C. S.D. O. 1959); *The Montana Power Company v. U.S.*, 145 Ct. Cls. 611, 171 F. Supp. 943 (Ct. Cls. 1959); *Appeal of Denholm & McKay Co.*, 2 B.T.A. 444 (1925), acq. IV-2 CB 2.

In its opinion denying rehearing (Appendix, *infra*, p. 19), the Fourth Circuit viewed the examples cited by Petitioners to show deductions for expenditures even though the advantages extended beyond the taxable year as ones where "the advantage acquired bore a close analogy to a 'wasting' asset." Quite to the contrary, however, the examples cited and relied upon by Petitioners to reflect such deductions did not involve advantages having definite measurable lives. In reference to the cases at bar, the Fourth Circuit said "it is reasonable to view the advantages acquired as having an unlimited life, and petitioner has made no showing to the contrary. Where the benefit derived from an expenditure cannot be expected to cease, it would seem inappropriate to grant a deduction either currently or amortized over a period of years." The Court apparently was unconcerned about the inappropriateness of denying deductions for expenditures made to reduce costs and thereby indefinitelyincrease taxable income. Furthermore, the Court did not recognize the rule that the life of the advantage or benefit secured by an expenditure is not the controlling test in determining whether a deduction is allowable for an ordinary and necessary business expenditure. *E. H. Sheldon & Co. v. Commissioner, supra,* quotation *supra* at p. 7.

The effect of the decisions below is to include within the

definition of a capital asset every business advantage or benefit which runs beyond the taxable year. Such an extension of the definition is clearly erroneous and contrary to the rule of this Court providing that the definition of a capital asset must be narrowly applied and the exclusions therefrom broadly interpreted. *Corn Products Refining Company v. Commissioner*, 350 U. S. 46 (1955). Such a change in a basic rule of taxation without the change evolving through the regular legislative processes and procedures will invite extensive litigation on a continuing basis. If such a change is to be made without enactment by Congress, then it should be done only after due consideration by this Court in order to assure clarity and uniformity throughout the United States.

As this Court long ago observed, taxation is a practical matter, and the laws in respect of it should be construed and applied with a view of avoiding, so far as possible, unjust and oppressive consequences. *Farmer's Loan & Trust Co. v. State of Minnesota*, 280 U.S. 204, 212 (1930). Here Petitioners made their 1964 payments solely to eliminate Crosswell and thereby be rid of Crosswell's burdensome and onerous contracts. That is all the payments secured. Petitioners after their payments had the same rights to bottle and sell Coca-Cola in the same territories as they had before. As a direct result of Petitioners' payments, Crosswell and its contracts were eliminated, and this reduced the cost of Coca-Cola syrup. The payments did not secure for Petitioners any new source of supply or any greater interest in or right to their existing source of supply. To deny Petitioners deductions for their payments made to be rid of burdensome and onerous contracts and thereby to increase their profits (and, incidentally, their income taxes) indeed would be oppressive.

CONCLUSION

For the reasons set forth above, Petitioners respectfully pray that a writ of certiorari issue to the Court of Appeals for the Fourth Circuit.

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